Exxon Chemical (M) Sdn Bhd v Ketua Pengarah Hasil Dalam Negeri

HIGH COURT (KUALA LUMPUR) — CASE STATED NO R2-14- OF 1998
AZMEL J
25 JANUARY 1999

Revenue Law *— Income tax — Deduction — Retirement and resignation benefits — Provision for such benefits which could not be determined with definite accuracy — Whether deductible — Income Tax Act 1967 s 33(1)*

Pursuant to its employees' retirement and resignation benefits scheme, the appellant had set aside a total sum of RM881,270 as vesting benefits and claimed the amount as a deduction of income tax under s 33(1) of the Income Tax Act 1967 ('the Act'). The respondent disallowed the deduction. The appellant's appeal to the commissioner of income tax was dismissed. Hence this appeal. The issue was whether the provision for accrued vesting benefits could qualify for deduction in computing the adjusted income of the appellant.

Held, dismissing the appeal with costs:

The provisions of the benefits, the amount of which could not be determined with exact/definite accuracy and which related to future expenses, cannot be allowable expenses deserving deduction under s 33(1) of the Act (see p 536G); *Southern Railway of Peru Ltd v Owen (Inspector of Taxes)* [1957] AC 334 followed; *Commissioner of Inland Revenue v Lo & Lo* [1984] STC 306 distinguished. Mere provisions without incurring any payment to the employees who may qualify cannot come within the ambit of this section (see p 538B); *Nilsen Development Laboratories Pty Ltd & Ors v Federal Commissioner of Taxation* [1981] ATC 4031 followed.

[Bahasa Malaysia summary

Menurut skim faedah persaraan dan perletakan jawatan pekerja, perayu telah memperuntukkan jumlah sebanyak RM881,270 sebagai faedah letakhak dan menuntut amaun tersebut sebagai potongan cukai pendapatan di bawah s 33(1) Akta Cukai Pendapatan 1967 ('Akta tersebut'). Penentang tidak membenarkan potongan tersebut. Rayuan perayu kepada pesuruhjaya cukai pendapatan telah ditolak. Dengan itu rayuan ini dibuat. Isu adalah sama ada peruntukan untuk faedah letakhak terakru adalah layak sebagai potongan dalam mengira pendapatan perayu yang terlaras.

Diputuskan, menolak rayuan dengan kos:

Peruntukan-peruntukan faedah-faedah, yang mana amaunnya tidak dapat ditentukan dengan kejituan yang pasti dan yang berkaitan dengan perbelanjaan masa depan tidak boleh dibenarkan sebagai

perbelanjaan yang layak mendapat potongan di bawah s 33(1) Akta tersebut (lihat ms 536G); *Southern Railway of Peru Ltd v Owen (Inspector of Taxes)* [1957] AC 334 diikut; *Commissioner of Inland Revenue v Lo & Lo* [1984] STC 306 dibeza. Peruntukan semata-mata tanpa menanggung sebarang bayaran kepada pekerja-pekerja yang mungkin layak tidak terangkum dalam lingkungan seksyen ini (lihat ms 538B); *Nilsen Development Laboratories Pty Ltd & Ors v Federal Commissioner of Taxation* [1981] ATC 4031 diikut.]

Notes

For cases on deduction, see 10 *Mallal's Digest* (4th Ed, 1996 Reissue) paras 1796–1822.

Cases referred to

Commissioner of Inland Revenue v Lo & Lo [1984] STC 306 (refd)
Nilsen Development Laboratories Pty Ltd & Ors v Federal Commissioner of Taxation [1981] ATC 4031 (folld)
Southern Railway of Peru Ltd v Owen (Inspector of Taxes) [1957] AC 334 (folld)

Legislation referred to

Inland Revenue Ordinance s 16(1) [HK]
Income Tax Act 1967 ss 33, (1)
Income Tax Act s 51(1) [Aust]

A Subramaniam (*Shook Lin & Bok*) for the appellant.
Salmah Kassim (Legal Officer) for the respondent.

Azmel J: This is an appeal by way of a case stated by the appellant against the decision of the pesuruhjaya khas cukai pendapatan made on 24 January 1997 which ruled that:

> Adalah diputuskan bahawa amaun berjumlah RM881,270 yang telah diperuntukkan dalam akaun perayu, termasuk amaun yang telah dikenakan kepada akaun untung rugi, tidak dibenarkan sebagai potongan di bawah s 33(1) Akta Cukai Pendapatan 1967.
>
> Maka dengan ini adalah diperintahkan bahawa rayuan ini ditolak. ...

The background of this case can be summarized as follows. The appellant had set up a retirement and resignation benefits for its employees in accordance with the provisions of the National Employees Benefit Manual. The purpose of the scheme was to provide benefits to national employees upon their retirement and also benefits for employees who resign or whose services have been terminated other than for cause. For the Years of Assessment 1986 to 1991, the appellant had set aside a total sum of RM881,270 and charged this amount as vesting benefits in its relevant accounting records and claimed the said amount as a deduction of income tax under s 33(1) of the Income Tax Act 1967. However, the Ketua

Pengarah Hasil Dalam Negeri ('the respondent') disallowed the said sum to be regarded as a deduction. As a result of that, an appeal to the pesuruhjaya khas cukai pendapatan was lodged by the appellant.

The main issue for the determination of the pesuruhjaya khas cukai pendapatan was whether the provision for accrued vesting benefits payable totalling RM881,270 could qualify for deduction under s 33(1) of the Income Tax Act 1967 in computing the adjusted income of the appellant for the Years of Assessment 1986 to 1991. At the end of the hearing of the appeal, the pesuruhjaya khas cukai pendapatan concluded that the said sum of RM881,270 did not qualify as deduction under s 33(1) of the said Act and as such the appeal was dismissed. It was against this decision that the appellant made this appeal to this High Court.

Counsel for the appellant and the respondent had agreed to give their submissions in writing. After having considered their written submissions in relation to the decision made by the pesuruhjaya khas cukai pendapatan, I held the view that the conclusion made by the pesuruhjaya khas cukai pendapatan was perfectly in order and I was unable to find any reason whatsoever to disturb it. As such I dismissed the appeal with costs. My reasons are as follows.

This is a very clear and straight forward case. I agree completely with the view of the pesuruhjaya khas cukai pendapatan when they said that in order to obtain a deduction under s 33(1) of the Income Tax Act, four elements have to be satisfied, namely:

(i) outgoing and expenses;

(ii) wholly and exclusively;

(iii) incurred during that period; and

(iv) in the production of income.

This means that the test of deductibility is that all outgoings and expenses must be incurred during the relevant period wholly and exclusively in the production of income. It was the conclusion of the pesuruhjaya khas cukai pendapatan that the provisions of the benefits, the amount of which could not be determined with exact/definite accuracy and which relate to future expenses cannot be allowable expenses deserving deduction under s 33(1) of the Income Tax Act. The Pesuruhjaya Khas relied on the House of Lords case of *Southern Railway of Peru Ltd v Owen (Inspector of Taxes)* [1957] AC 334 which I consider to be a very relevant authority on the issue before this court. In their decision, the pesuruhjaya khas cukai pendapatan had considered *Owen*'s case not only at stage in the House of Lords but also at the level of the High Court as well as the Court of Appeal. I shall first begin to refer to the judgment of Jenkins LJ, sitting as a judge in the Court of Appeal, who stated:

> The principle ... justifying the deduction is, I think, only applicable as far as liabilities are concerned where both the following conditions are satisfied, namely: (i) the liability must be certain not contingent ...; and (ii) the benefit, in respect of which the liability is incurred, must be exclusively referable to the

A year in which it is sought to debit the liability as an expense; or in other words where, as in the present case the benefit consists of services, the liability must be an obligation incurred in that year exclusively in respect of services rendered during the year.

Another judge, sitting as a member of the Panel of the Court of Appeal, B Rommer J, stated as follows:

It may be reasonable commercial practice for the directors to deduct the sum for the purpose of arriving at net profit for distribution among the shareholders but that is not the point: the point is whether they are entitled to deduct it as against the Crown for the purpose of arriving at the profit on which they are liable to be taxed and in my opinion they are not, for the sums, C being neither payable at once nor certainly payable in the future cannot rightly be regarded as part of a definite price which the company has to pay for the services of the hypothetical servant during the year of deduction or, indeed, during any particular year.

The appellant's reliance on the Hong Kong case of *Commissioner of Inland Revenue v Lo & Lo* [1984] STC 306 was rejected by the Pesuruhjaya Khas D because the *Lo & Lo* case was based on s 16(1) of the Hong Kong's Inland Revenue Ordinance which is not akin to s 33(1) of the Malaysian Income Tax Act 1967. The main difference is that the Hong Kong law provides for 'any period' while s 33(1) of Malaysian Income Tax Act states 'during that period'. Section 16(1) of the Hong Kong Income Tax Act is very wide E whereas s 33(1) of the Malaysian Tax Act is very restrictive. Section 33(1) of the Income Tax Act states:

Subject to this Act, the adjusted income of a person from a source for the basis period for a year of assessment shall be an amount ascertained by deducting from the gross income of that person from that source for that period all outgoings and expenses wholly and exclusively incurred *during that period* by F that person in the production of gross income from that source including. (Emphasis added.)

It was the view of the pesuruhjaya khas cukai pendapatan that the liability is prospective or contingent until the employee retires or becomes entitled to the retirement benefits under the terms of the manual. Until such time, G the appellant was under no liability to pay. And by virtue of the manual, the right which will arise and the exact amount due as retirement or resignation depends primarily on:

(a) the final monthly basic salary;

(b) the years of accredited service at the time of such retirement or H resignation.

As such, any detailed breakdown figure prematurely prepared is only provisional and cannot be satisfactorily determined or fairly estimated until after the retirement, or death or termination of services of the employees. In addition to that, how would the applicant account for the amount accrued I in respect of employees who may be terminated for cause?

Upjohn J, the High Court judge who heard *Owen*'s case, said:

> ... deferred payments must be brought into account of Income Tax purposes at the time when they become payable upon the death or retirement of any given employee and not before.

The pesuruhjaya khas cukai pendapatan also held the view that mere provisions without incurring any payment to the employees who may qualify cannot come within the ambit of s 33(1) of the Income Tax Act 1967. In support of this view, the pesuruhjaya khas cukai pendapatan relied on the Australian Full High Court case of *Nilsen Development Laboratories Pty Ltd & Ors v Federal Commissioner of Taxation* [1981] ATC 4031, upholding the decision of the Full Federal Court which held that the taxpayer, claiming a deduction under s 51(1) of the Australian Income Tax Act in its return for the income year ended 30 June 1974 in respect of a provision in its financial accounts representing an estimate of what it would be bound to pay the employees if they had been on leave during the year of income, was not entitled to the deduction.

On appeal, the Australian Full High Court held:

> No deduction under s 51(1) in respect of annual or long service leave of any amount can properly be claimed by an employee bound by an award or industrial agreement substantially in terms of the present awards until the employee takes the leave (or events occur such as death, termination of employment in certain circumstances, by reason of which the employer is bound to make the payment). Then, and only then for the first time, there is a present liability to pay money and then, and only then, there is an outgoing which is deductible under the provision of s 51(1).

Section 51(1) of the Australian Income Tax is akin to s 33(1) of the Malaysian Income Tax Act.

As I have fully agreed with the decision of the pesuruhjaya khas cukai pendapatan and endorsed their reasons for the decision, I dismissed the appeal with costs.

Appeal dismissed with costs.

Reported by Loo Lai Mee